UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF COLORADO
Honorable Howard R. Tallman

In re:	)	
	)	
DENVER COMMUNITY DEVELOPMENT CREDIT UNION,	)	**Case No. 04-23761 HRT**
	)	**Chapter 11 (Involuntary)**
Debtor.	)	
	)	

ORDER ON MOTION FOR SANCTIONS PURSUANT TO FED. R. BANKR. P. 9011

This case comes before the Court on the Denver Community Federal Credit Union's [the "Credit Union"] Motion for Sanctions Pursuant to FED. R. BANKR. P. 9011 [the "Motion"]; United States Trustee's Statement in Support of Motion for Sanctions; and the responses filed by the Association. The Court held a hearing on September 22, 2004. Denver Community Federal Credit Union, successor in interest to Denver Community Development Credit Union, appeared through counsel Brian J. Holst; Bruce Randolph Merchants & Civic Association, Inc. appeared through counsel Kristal Bernert; The United States Trustee appeared through Leo Weiss; Thomas Foster appeared *pro se*; and Kristal Bernert appeared *pro se*.

The Motion prays for sanctions to be assessed against Kristal Bernert, attorney for the Association, and against Thomas Foster, a board member of the Association. Sanctions are sought both under FED. R. BANKR. P. 9011 and under 11 U.S.C. § 303(i).

Background and Facts

1. The Denver Community Development Credit Union was created through the efforts of the Bruce Randolph Merchants & Civic Association, Inc. [the "Association"] to provide services to small business and residents within a defined community.

2. Problems developed in the operations of the Denver Community Development Credit Union which resulted in the Commissioner of Financial Services, State of Colorado, being appointed as conservator under Colorado law. By a resolution of the Denver Community Development Credit Union's board of directors, dated February 9, 2004, it consented to the conservatorship.

3. On June 25, 2004, the Denver Community Development Credit Union was merged with Denver Community Federal Credit Union to insure the continuation of its services.

4. Also, on June 25, 2004, the Civic Association filed this Involuntary Petition.

5. Subsequent to the filing of the Involuntary Petition, but also on June 25, 2004, the Denver Community Development Credit Union's Certificate of Dissolution was filed with the Colorado Secretary of State.

6. Thomas Foster is a member of the board of directors of the Association. Mr. Foster consulted with counsel, Ms. Bernert on behalf of the Association and signed the Involuntary Petition filed in this case on behalf of the Association.

7. By order of this Court dated September 2, 2004, the Court dismissed the Involuntary Petition.

Sanctions Under 11 U.S.C. § 303(i)

The Bankruptcy Code provides that

> If the court dismisses a petition under this section [§ 303] other than on consent of all petitioners and the debtor, and if the debtor does not waive the right to judgment under this subsection, the court may grant judgment–
>
> (1) against the petitioners and in favor of the debtor for–
> (A) costs; or
> (B) a reasonable attorney's fee; or
> (2) against any petitioner that filed the petition in bad faith, for–
> (A) any damages proximately caused by such filing; or
> (B) punitive damages.

11 U.S.C. § 303(i).

The Association did file an Involuntary Petition under § 303 and that petition was dismissed. The dismissal was not on consent of the parties and the Credit Union did not waive its right to seek judgment under § 303(i). Thus, the statutory prerequisites to judgment under § 303(i)(1) for an award of costs and fees have been satisfied.

An award of actual damages or punitive damages under § 303(i)(2), however, requires a showing of bad faith. The Court heard testimony from the Credit Union's witness and from the representative of the Association. The Court is satisfied that the Involuntary Petition was not motivated by any spite or malice on the part of the Association or its representatives. The Court credits Mr. Foster's testimony that the Association's goal was to try and reorganize a credit union that was started to serve a specific community. While that credit union may not be unique in any legal sense that would make it eligible to be a debtor under § 109, it certainly is unique in terms of the history of its creation and the community involvement in its operation. The Court cannot

find any indicia of bad faith in the Association's attempt to rehabilitate that community asset. Accordingly, the Court will not further consider an award of actual or punitive damages under § 303(i)(2) and will focus its attention on whether or not an award of fees and costs under § 303(i)(1) is called for.

While a judgment under § 303(i)(1) is not mandatory, and lies within the sound discretion of the Court, *In re Hoover*, 32 B.R. 842, 851 (Bankr. W.D. Okla. 1983), in the normal case, an award of costs and/or attorney fees will be appropriate. *Higgins v. Vortex Fishing Systems, Inc.*, 379 F.3d 701, 707 (9th Cir. 2004) ("when an involuntary petition is dismissed on some ground other than consent of the parties and the debtor has not waived the right to recovery, an involuntary debtor's motion for attorney's fees and costs under § 303(i)(1) raises a rebuttable presumption that reasonable fees and costs are authorized"); *In re Scrap Metal Buyers of Tampa, Inc.*, 253 B.R. 103, 109-110 (M.D. Fla. 2000) (adopting rebuttable presumption approach); *In re Squillante*, 259 B.R. 548, 553-54 (Bankr. D. Conn. 2001); ("Courts generally hold that the exercise of the court's discretion is based on the totality of the circumstances; that there is a presumption that costs and attorney's fees will be awarded to the alleged debtor following dismissal of an involuntary petition; and that the burden of proof is on the petitioner to justify a denial of costs and fees."); *In re Leach*, 102 B.R. 805, 808 (Bankr. D. Kan. 1989) ("Although the award of attorney's fees and costs is discretionary, section 303(i)(1) routinely contemplates the award of costs and attorney's fees to the debtor.").

The structure of the statute itself makes it clear that an award of costs and fees under § 303(i)(1) is not based in fault or bad motive because a separate subsection provides for damages when bad faith is involved. 11 U.S.C. § 303(i)(2); *In re Advance Press & Litho, Inc.*, 46 B.R. 700, 702-703 (Bankr. D. Colo. 1984). The provision for an award of fees and costs without a finding of bad faith simply reflects that, in balancing the interests of an alleged debtor against the interests of a petitioning creditor, the alleged debtor should not normally be expected to bear the expense of defending against an involuntary petition which is ultimately determined to be without merit. As noted above, after having listened to the testimony, the Court finds that, in fact, neither the Association nor Thomas Foster acted in bad faith.

The Credit Union does not ask the Court to assess fees and costs against the Association, but it does ask this Court to assess those fees and costs against Thomas Foster personally. The Court cannot assess expenses against Mr. Foster. The Court finds no authorization in the statute to make an assessment under § 303(i)(1) against any party other than the petitioning creditors. The Association is the petitioning creditor, not Mr. Foster individually.

Furthermore, Mr. Foster's status was that of an agent acting on behalf of a fully disclosed principal. Under the law of agency, it is axiomatic that it is the principal who bears the liability for the acts of its agent where the agent acts on behalf of the principal and discloses that relationship. *Leonard v. McMorris*, 63 P.3d 323, 330 (Colo. 2003). After hearing Mr. Foster's testimony and reviewing the resolution offered into evidence by the Association along with the

Involuntary Petition filed by Mr. Foster on the Association's behalf, the Court is satisfied that Mr. Foster acted on behalf of the Association with its full authorization and that the agency relationship was fully disclosed. The Court heard no evidence from the Credit Union to contradict that conclusion. Therefore, no basis exists to hold Mr. Foster liable.

That said, the Court will not make an assessment of attorney fees and costs against the Association. The only evidence that the Court has before it as to those fees is a statement by the Credit Union's witness that the cost of defending the Involuntary Petition was about $6,000.00. That evidence is insufficient for an award of attorney fees.

The Court awards fees under § 303(i)(1) which are reasonable and necessary to defend against the Involuntary Petition. *In re Paczesny*, 282 B.R. 646, 650 (Bankr. N.D. Ill. 2002); *In re Landmark Distributors, Inc.*, 195 B.R. 837, 848 (Bankr. D. N.J. 1996); *In re Atlas Mach. and Iron Works, Inc.*, 190 B.R. 796, 803 (Bankr. E.D. Va. 1995); *In re Val W. Poterek & Sons, Inc.*169 B.R. 896, 906-907 (Bankr. N.D. Ill. 1994). The burden is upon the fee applicant to prove the reasonableness and necessity of the fees applied for. *Landmark Distributors*, 195 B.R. at 848.

The Court has no evidence before it as to the number of hours expended by the Credit Union's attorneys or the hourly rates charged. The Court simply has no record upon which it may make findings as to the reasonableness and necessity of the fees incurred. Under the circumstances, the Court must deny a fee award to the Credit Union based upon a failure to carry its burden.

Sanctions Under FED. R. BANKR. P. 9011

The Credit Union asks the Court to assess sanctions against the Association's counsel for violation of her ethical responsibilities under FED. R. BANKR. P. 9011. Subsection (b) of Rule 9011 describes the representations that any practitioner or *pro se* party makes to the Court by signing a pleading:

> By presenting to the court (whether by signing, filing, submitting, or later advocating) a petition, pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances,--
>
> (1) it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;
>
> (2) the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the

establishment of new law;

(3) the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and

(4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.

FED. R. BANKR. P. 9011(b). Since an attorney's signature on any pleading constitutes that attorney's representation to the court that each and every one of the four subsections of Rule 9011(b) are true, if any one of them is not true, then the attorney has violated the Rule.

Ms. Bernert has violated Rule 9011(b)(2). Despite the fact that § 109(b)(2) in conjunction with § 109(d) of the Bankruptcy Code, in clear and straight-forward language, prohibit a credit union from being a debtor under chapter 11, Ms. Bernert went forward with the filing of an Involuntary Petition under chapter 11 against the Denver Community Development Credit Union.

Ms. Bernert's argument in support of the filing was frivolous. She argued that this particular credit union did qualify for chapter 11 relief because it wasn't merely a credit union, it was a *cooperative* credit union. In the Court's Order Granting Motion to Dismiss, the Court pointed out that relevant statutes and case law are devoid of any reference to a cooperative credit union as a distinct type of entity from any other credit union. In fact, all credit unions are cooperative associations by definition. Consequently, legal contentions contained in Ms. Bernert's pleadings were not "warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law."

The standard is an objective one rather than subjective. *White v. General Motors Corp., Inc.*, 908 F.2d 675, 680 (10th Cir. 1990). The Court does not look to whether or not Ms. Bernert had a good faith belief in the argument she presented. "The standard is 'whether a reasonable and competent attorney would believe in the merits of an argument.'" *Kusic v. Mathis (In re Yellow Cab Cooperative Ass'n*), 144 B.R. 505, 510 (D. Colo. 1992) (quoting *Dodd Ins. Servs. v. Royal Ins. Co. of Am.*, 935 F.2d 1152, 1155 (10th Cir. 1991)). The Court has to conclude that a reasonable and competent attorney would not advance an argument that a *cooperative* credit union is not a credit union as that term is used in § 109(b)(2). Since credit unions are, by definition, cooperative associations, it defies logic to argue that Congress intended to exclude *cooperative* credit unions from the prohibition in § 109(b)(2).

Assuming that Ms. Bernert did the same research that the Court did before filing the petition, she must have known that there is no case law which supports her argument. She must have known that there are no statutes which make the distinction that she sought to make. She

must have known that the statutory definition of a credit union makes the logic of her argument fall apart. If Ms. Bernert did not do that rudimentary research before filing the petition, she should have.

The result of filing a frivolous petition is not only a cost of time and expense to the Alleged Debtor, but a waste of the Court's valuable resources--time that is sorely needed to address the many meritorious cases pending before this Court.

Before awarding sanctions, the Court must consider at least three factors: "(1) the opposing party's reasonable expenses incurred as a result of the violation, including reasonable attorney fees; (2) the minimum amount necessary adequately to deter future misconduct; and (3) the offender's ability to pay." *Masunaga v. Stoltenberg (In re Rex Montis Silver Co.)*, 87 F.3d 435, 439-40 (10th Cir. 1996) (citing *White v. General Motors Corp., Inc.*, 908 F.2d 675, 684-85 (10th Cir.1990)).

The same insufficiency of the evidence that led the Court to deny sanctions under § 303(i) also leads it to deny an award of sanctions to the Credit Union under Rule 9011. The record that is before the Court gives the Court no basis to make a finding on the reasonableness or necessity of the fees incurred. *White v. General Motors Corp., Inc.*, 908 F.2d at 684 ("Because the sanction is generally to pay the opposing party's 'reasonable expenses . . . including a reasonable attorney's fee,' Fed. R. Civ. P. 11, determination of this amount is the usual first step. The plain language of the rule requires that the court independently analyze the reasonableness of the requested fees and expenses."). In addition, fairness to the Association's counsel requires that she receive information on the requested fees that contains enough detail for her to analyze and lodge any appropriate objections to those fees. *Id*. at 686 ("an adequate opportunity to respond to an attorney's fee request requires that the persons to be sanctioned be provided enough detail concerning the basis of the requested fees to permit an intelligent analysis.").

It is with some reluctance that the Court reaches this result. The Involuntary Petition that was filed in this case was wholly without merit. The Credit Union was put into the position of hiring counsel to mount a defense and its counsel did an excellent job in briefing the matter and arguing before the Court. The Bankruptcy Code and the case law clearly favor making the Credit Union whole with respect to that expense. The Rule and the case law also favor granting a sanction that will deter an attorney from asserting a position that is without legal support and without merit as an extension of current law. But, under either § 303(i) or Rule 9011, the primary focus is the reasonableness and necessity of the attorney fees. The Court may be willing to sanction the Association and its counsel with respect to the filing of the Involuntary Petition, but both parties must be held to the same standard of knowing what is necessary to meet their respective burdens. On the sanctions issue, that burden lay with the Credit Union. The Court cannot, in good conscience, give the Credit Union a second bite at the apple to perfect the record with respect to the fees incurred.

Furthermore, under the circumstances of this case, a monetary sanction is not required to deter future violation of rule 9011 by the Association's counsel. Under Rule 9011, the Court does have greater leeway to fashion a sanction than it does under § 303(i). The Court could set a penalty amount to be paid to the Court, as the U.S. Trustee suggests, or could fashion some non-monetary sanction. The Court declines to do so. The Court sincerely hopes and believes that counsel for the Association has learned a valuable lesson, albeit at a cost to both the Credit Union and the Court. The Court expects that the experience of going through a sanctions hearing relatively early in her legal career has been distinctly unpleasant for the Association's counsel. That experience should have educated counsel to the absolute necessity of taking seriously her ethical obligation to refrain from asserting a frivolous position, no matter how noble the cause may seem to be. It should also have educated counsel to the costs involved in time and resources to all parties involved, including the Court. Finally, she may also expect that she is unlikely to again receive the benefit of the doubt from this Court if similar events should be repeated in the future.

In accordance with the above discussion, it is

ORDERED that Denver Community Federal Credit Union's Motion for Sanctions Pursuant to FED. R. BANKR. P. 9011, and relief requested in the United States Trustee's Statement in Support of Motion for Sanctions is hereby DENIED.

Dated this 5th day of October, 2004.

BY THE COURT:

/s/ Howard R. Tallman
Howard R. Tallman, Judge
United States Bankruptcy Court